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SUBJECT: DOHA CONFERENCE PREDICTS SHORT-TERM NATURAL GAS  
GLUT, LONG-TERM SUPPLY CRUNCH

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KEY POINTS  
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-- The global economic crisis is a temporary blip for the long-term trend of strong demand growth for natural gas worldwide, according to industry leaders who participated in the recent annual natural gas conference in Qatar.

-- In the short term, however, depressed global demand will result in a large-scale shift in liquefied natural gas (LNG) from east to west, as the Atlantic basin has the regasification and storage capacity to deal with excess supply. In the U.S., weak demand coupled with new sources of domestic supply will lead to low prices.

-- There is still a clear division between "firm" markets (Asia) and "flexible" markets (Atlantic Basin - the U.S. and, to a lesser extent, Europe) for natural gas, though increasing interactions between these markets is enhancing globalization of the commodity. The growth in LNG trade - with Qatar at the forefront - and attendant spot sales is driving much of this changing dynamic.

-- Current low prices, coupled with continued high costs for new liquefaction capacity, raises a big challenge for the energy industry to invest properly now to meet future demand needs.

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COMMENT  
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-- Qatari representatives at the conference insisted their country is committed to its long-term vision of playing a major role supplying all three major markets in Asia, Europe, and the U.S. They occasionally acknowledged short-term challenges for the industry, but said they are under no pressure to look for new markets, and believe the long-term trends still favor natural gas being a seller's market.

-- However, Qatar may need to rethink in the short-term some of its price demands, due to the coming global glut of natural gas supply. Unfortunately for Qatar, which will add 47 mta of capacity in the next two years, its new supply is hitting the market right as demand is flagging and spot and oil-indexed gas prices are under pressure.

End Key Points and Comment.

## Concern Over Global Economic Crisis

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¶1. The Seventh Doha Natural Gas Conference, held March 9-12, provided industry experts an important forum for debating current trends in the natural gas markets. The Amir of Qatar opened the conference, and the sessions featured a wide range of government officials, business representatives, and independent analysts. Reduced global natural gas demand due to the economic crisis and the attendant disincentive for further investments in energy production was a key concern of most participants -- e.g., the Amir cited a need for "an encouraging price to justify investments," and the Energy Minister made it clear Qatar has not yet decided on further supply expansions.

### Long-Term Trend for Higher Gas Demand, Even as Economic Crisis Takes a Bite

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¶2. Most presenters believed demand for natural gas would decline relatively less than demand for oil during the economic crisis and recover with a continued supply shortage persisting in the future, once the current crisis abates.

¶3. Independent analyst (and former BP official) Andy Flower predicted that in the short-term, there is likely to be a lot of LNG without committed markets - up to 30 million tons per annum (mta) of spot sales in 2009 and 50 mta in 2010. He noted the global LNG trade fell last year by 0.8 mta, which

DOHA 00000224 002 OF 003

was the first drop since 1981, and there was a 5 percent drop in Asian LNG consumption in Q4 2008 compared to 2007. Several speakers pointed to the currently low prices for gas -- under USD 4 per million btu at Henry Hub -- as providing a disincentive for further investment.

¶4. Over the long-term, however, Flower and other analysts projected a continued shortage of LNG and said the global market may have a shortfall of 120 mta by 2020. (Note: this prediction is notional as it is unclear what global production will be beyond 2012 because it takes 4 years minimum to set up a new LNG plant). Much of the future supply-demand gap depends on decisions made now and in the next few years to start building new liquefaction capacity.

¶5. Flower assessed that it is difficult to see where growth in LNG supply will come from. The industry is in a "wait and see" mode because of the financial crisis - especially because commodity price falls haven't translated yet into lower liquefaction plant costs. Still, he projected that global LNG demand would grow 5 percent a year between 2013 and 2020, after averaging 7.4 percent annual growth between 1964 and 2008.

¶6. Several other speakers pointed to trends leading to continued strong growth in demand for LNG imports worldwide:

-- China and India are now entering an energy-intensive phase of development. Lower natural gas prices could prompt these and other developing economies to alter their energy production capabilities in favor of natural gas-fired production - significantly adding to pressures on supply over the next several years. (Note: Just before the conference PetroChina signed a new 25-year contract with QatarGas for 3 mta of LNG.)

-- Carbon reduction requirements in Europe and elsewhere could accelerate adoption of natural gas as a cleaner fossil fuel.

-- Many new countries are planning LNG imports for the first time to diversify their energy sector, while many former exporters are also becoming importers (e.g., Canada, Mexico,

Indonesia).

## Steps Toward Globalization of Natural Gas, Though Regional Divergence Continues

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¶7. Birger Balteskard, Commercial Manager for ConocoPhillips UK, assessed that the growing use of natural gas in the Atlantic Basin's flexible market will over time require higher commodity prices that compete with Asia's long-term contracts - a possible first step towards globalization of natural gas as a commodity. In a corollary to this, Flower noted that price convergence within the Atlantic Basin is likely over the next few years due to market flexibility driven by LNG growth.

¶8. Note: LNG spot sales have been rising and continuation of this trend will support price convergence. Such sales accounted for about 20 percent of LNG trade in 2007, according to Jean-Luc Colonna of GDF Suez. Still, LNG is only a portion of overall natural gas demand.

¶9. Kathleen Eisbrenner, Executive VP for Global LNG at Shell, argued that global LNG markets are still resisting convergence. Asian customers in particular see a supply security benefit to long-term contracts, while shale gas plans in the U.S. are undercutting the rationale for imports. As a result, she expected U.S. Henry Hub prices to remain decoupled from global natural gas pricing, particularly if new technologies and availability of shale gas resources helps the U.S. successfully reverse its long-term decline in domestic production.

¶10. Eisbrenner pointed to Europe as "the place to watch the next two years." Investment and demand there can determine how much market share LNG deserves.

DOHA 00000224 003 OF 003

## U.S. Market Seeing Fundamental Changes

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¶11. U.S. demand for LNG imports is now forecast to be dramatically lower than previously thought (Balteskard cited figures of demand for 13 mta of LNG, which is 75 percent less than predictions four years ago). David Small from Trinidad and Tobago's Ministry of Energy cited estimates of recoverable gas in U.S. shale basins as now dramatically higher than before (742 trillion cubic feet estimate in 2008, compared to 215 tcf estimate in 2006).

¶12. At the same time as domestic gas supply is increasing, the U.S. is the "market of last resort" for LNG. In the summer, when natural gas demand is low, there is a "demand push" where excess gas is delivered to the U.S., usually at low prices. A slackening of demand due to the economic crisis only accelerates this push. The unbalanced situation is compounded by the possibility of cheap domestic shale gas.

¶13. Small predicted the U.S. swing market would take center stage in 2009, and sellers will receive low prices for their gas.

## Qatar the Major Market Player

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¶14. The steadily increasing importance of Qatar to the global natural gas trade is obvious from a quick look at the numbers presented at the conference. Qatar is projected to boost output by about 20 mta in 2009 (to about 50 mta), and should reach 77 mta by 2010 when all the LNG trains under construction have been commissioned. The addition of 47 mta in Qatar amounts to half the 95 mta of new global capacity coming on-line between 2009-2012, and will cement the country's place as the world leader in LNG exports.

¶15. Qatar's LNG-centric export strategy -- based on using mega-tankers from its central geographic position to supply major consuming centers in Asia and the Atlantic Basin -- will help the small state play a leading role in any harmonization of global natural gas markets. Fully 25 percent of global LNG supply will come from Qatar post-2010. In comments at the conference, Qatar's Energy Minister Abdullah Al-Attiah said that developing further gas production capability is "under study" and Qatar is "not in a hurry" to develop additional supply capacity.

#### Artificially Low Prices Keep Middle East Natural Gas Markets Distorted

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¶16. Michael Corke of Pervin and Gertz, Inc., in a presentation on natural gas in the Middle East, pointed out that Iran and Qatar are the two dominant regional producers and their capacities and policies are essential for forecasting the region's gas supplies. Corke said Iran has been successful in using gas for domestic production but still lags far behind Qatar in the LNG sector.

¶17. Fereidun Fesharaki of FACTS Global Energy noted that most MENA countries keep gas for domestic use priced well under market value, leading to excessive demand. He argued that Iran and Qatar are very different as producers. Iran has very little export room, and LNG exports are unlikely to materialize there before 2015 at the earliest. The majority of the Iranian parliament and society are against exporting gas, as they want to consume it at home. The government is in a dilemma, in Fesharaki's view, because it can't change the domestic price fast (for fear of unrest) and it faces strong popular opposition to exporting the product. He concluded by observing that even the most optimistic scenario for Iran suggests it will only produce 20-36 mta of LNG in the next few years - not at all in Qatar's league.

LeBaron